

"Stranded Utility Asset Securities": Asset Backed Securities backed by cash flow from stranded utility assets and other costs authorized for recovery by state law in the jurisdiction of the related utility.

"Structured Finance Security": Any CDO Security, CMBS Security or other registered asset backed security, including any CDS Asset, the CDS Reference Obligation with respect to which is a Structured Finance Security; *provided*, that either such security (or, with respect to a CDS Asset or Covered Short CDS Asset, the CDS Reference Obligation) is treated as debt for U.S. federal income tax purposes or the issuer thereof is not a U.S. person and is treated as a corporation that is not a United States real property holding corporation as defined in Section 897(c)(2) of the Code for U.S. federal income tax purposes.

"Structured Settlement Security": A security that provides for the disbursement of money for an injured person's legal claim where all or part of the arrangement calls for future periodic payments.

"Student Loan Securities": Securities that entitle the holders thereof to receive payments that depend (except for rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of the securities) on the cash flow from loans made to students (or their parents) to finance educational needs.

"Tax Lien Securities": Asset Backed Securities that entitle the holders thereof to receive payments that depend (except for rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of the Asset Backed Securities) on the cash flow from a pool of tax obligations owed by businesses and individuals to state and municipal governmental taxing authorities, generally having the following characteristics: (1) the obligations have standardized payment terms and require minimum payments; (2) the tax obligations are obligations of numerous borrowers and accordingly represent a very diversified pool of obligor credit risk; and (3) the repayment stream on the obligation is primarily determined by a payment schedule entered into between the relevant tax authority and obligor, with early repayment on such obligation predominantly dependent upon interest rates and the income of the obligor following the commencement of amortization.

"Time Share Securities": Asset Backed Securities that entitle the holders thereof to receive payments that depend primarily on the cash flow from residential mortgage loans (primarily secured on a first priority basis, subject to permitted liens, easements and other encumbrances) by residential real estate the proceeds of which were used to purchase fee simple interests in timeshare estates in units in a condominium, generally having the following characteristics: (1) the mortgage loans have standardized payment terms and require minimum monthly payments; (2) the mortgage loans are obligations of numerous borrowers and accordingly represent a diversified pool of obligor credit risk; (3) repayment of such securities can vary substantially from their contractual payment schedules and depends entirely upon the rate at which the mortgage loans are repaid; and (4) the repayment of such mortgage loans is subject to a contractual payment schedule, with early prepayment of individual loans depending on numerous factors specific to the particular obligors and upon whether, in the case of loans bearing interest at a fixed rate, such loans or securities include an effective prepayment premium and with early repayment depending primarily on interest rates and the sale of the mortgaged real estate and related dwelling and generally no penalties for early repayment.

"Tobacco Settlement Securities": Asset Backed Securities that entitle the holders thereof to receive payments that depend (except for rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of the Asset Backed Securities) on the cash flow from receivables representing the right of litigation claimants in legal actions related to tobacco products to receive future scheduled payments under settlement agreements that are funded by annuity contracts, which receivables may have varying maturities.

"Toggle Security": Any floating rate security that is a U.S. agency security and has a complex condition on its floating rate.

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# EXHIBIT 86





## Memo

To: Thomas Gandolfo  
 Cc: Scott Gordon, Mike Gerity  
 From: David Salz, Christine Lachnicht, Vandana Sharma  
 Date:  
 Re: Class V III – Surveillance Update

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Class V Funding III was approved by the underwriting committee on March 16, 2007.

Issuer	Class V Funding III. Ltd.
Manager	Credit Suisse Alternative Capital
Underwriter	Citigroup
Trustee	ABN AMRO
Legal Final	February 22, 2052
Reinvestment Period	Limited over 3 years (up to 10% including redemptions)
Assets	100% single A mezzanine CDO of ABS (including 2% CDO <sup>2</sup> )
Size	\$1 billion
Ambac Attachment	50%
Ambac Exposure	\$500
AAA Attachment	18%
Controlling Class	The Class A1 Notes (protected by Ambac)
Funded/Unfunded	The class is unfunded. Funded notes will be created after losses, physical settlements and cash investments (limited to 20%) exceed 50%. Repayment of any funded note is senior in the interest and principal waterfall. CDS counterparty is responsible to fund these amounts.
CDS Counterparty	BNP
Ambac CDS obligations	Ultimate payment of principal on any funded notes and timely payment of interest and commitment fees

## Executive Summary on Rating Actions:

- All 58 of the assets in this CDO are single A rated tranches of mezzanine CDO of ABS. The assets underlying these mezzanine CDO of ABS are predominantly Baa2/Baa3 rated midprime/subprime RMBS.
- At the current time, 20% of the portfolio is on Moody's negative watch and 12% is on S&P's negative watch. The combined list represents 26% of the portfolio. Although there have been no downgrades, the expectation is that downgrades will follow in the next two months. The portfolio suffered higher levels of rating actions as compared to a similar transaction (i.e., 888). However, if all tranches on watch (i.e., 26%) with zero recovery, Ambac would still have nearly 50% of its initial subordination (i.e., 24%).
- The transaction pays principal sequentially from origination and all OC and IC tests are passing at the current time. We expect that when the rating actions are finalized that junior OC tests may fail (next 6 months). In the short term, this is not too meaningful to us as expected portfolio principal amortization in the near term is minimal. As the next senior OC test fails, Ambac's exposure will begin declining through the diversion of excess cashflows through the interest waterfall.
- Pool is composed of both trigger and triggerless CDO of ABS. For trigger deals, the PIK (pay-in-kind) risk is that downgrades and incorporated asset haircuts in the overcollateralization tests of the underlying single A CDOs could lead to a shutoff of interest payments to the single A CDO. Triggerless deals do not have PIK risk. Initial assessment is that there is one transaction that may PIK in the near future (out of 58 investments). We do expect a few of the triggerless deals to be downgraded to the single B to double BB category based upon the percentage of underlying collateral downgraded.
- Underwriting stresses on the portfolio looked at a portfolio wide 3 notch downgrade (Aaa) and 6 notch downgrade (Aa2). Underwriting stresses including evaluating single A CDO losses based upon cumulative mortgage losses of 15-17% which exceeds the current view on the 2006 vintage. This result is explained in part by the diversification of asset pools in each underlying CDO of ABS (rating, vintage, asset type).
- What has changed since underwriting is an appreciation that as S&P drops more BBB/BB RMBS to CCC, synthetic transactions (most of the 2006 vintage) will experience overcollateralization test failures on trigger deals leading to a high probability of tranches PIKing; further, the right of the counterparty to deliver the security to the CDO has been accelerated as the CCC level allows physical settlement. Careful monitoring of trustee reporting is critical given the magnitude of changes in the underlyings.
- Based upon marks as of June 30, 2007 and provided to us by the manager, the portfolio was marked at \$635 million (63.5%) (127% coverage to Ambac's class).
- Ambac's remedies beyond subordination are the following:
  - Overcollateralization and Interest Coverage diversion triggers.
  - Ability to replace the manager at effectively 177% of the initial exposure (currently 200.4%)
  - Ability to call an Event of Default at 169% of the initial exposure (currently 200.4%)
  - Ability to direct liquidation at effectively 125% of the initial exposure (currently 200.4%).
- In summary, this transaction will have additional marks. While we do not see a future claim, our level of confidence is less than with our other transactions and should be carefully monitored.

**CLASS V FUNDING III, LTD. TRANSACTION SUMMARY**

Overview of the transaction	CDO squared of Single A CDO of Mezzanine ABS. The Moodys WARF at origination was 120 (A2). Current WARF estimated to 147 (A2/A3). Max WARF is 125. (Aa2/Aa3). There is one position in a CDO squared (2%) and one position in an RMBS bespoke (2%).								
Attachment points	The natural AAA attachment point at close was 18%. Ambac's 50% attachment is approximately 2.8x this level.								
Collateral	Aggregate Collateral: \$1.00 billion collateral pool comprising of 58 issuers. Up to 100% can be synthetic positions and up to 20% can be cash positions. In the most recent trustee report, 13.2% is in cash securities.								
Amount of collateral in the deal impacted by the recent Moody's and S&P rating actions (RMBS and CDO)	As this is a pool of CDOs and to date no CDOs have been actually downgraded, we have highlighted tranches that S&P or Moody's has placed on negative watch.								
	Deal Name	Current Face	Moody's Action	Previous Rating	Current Rating	S&P Action	Previous Rating	Current Rating	% of Fund
	ACABS 2006-2A A3L	\$ 19,936,986	watch	A2	A2	watch	A	A	1.99%
	ACABS 2006-1A A3L	\$ 19,928,254			A2	watch	A	A	1.99%
	CETUS 2006-2A B	\$ 20,000,000	watch	A2	A2			A	2.00%
	CETUS 2006-3A C1	\$ 20,000,000	watch	A2	A2			A	2.00%
	JACKS 2006-4A D	\$ 20,000,000	watch	A1	A1			A	2.00%
	MKP 6A C	\$ 20,000,000	watch	A2	A2			A	2.00%
	LCERT 2006-1A B	\$ 20,000,000	watch	A2	A2			A	2.00%
	TABS 2006-5A A3	\$ 20,000,000	watch	A2	A2			A	2.00%
	TABS 2006-6A A3	\$ 20,000,000			A2	watch	A	A	2.00%
	DGCDO 2006-2A C	\$ 20,000,000	watch	A2	A2	watch	A	A	2.00%
	VELA 2006-1A C	\$ 20,000,000	watch	A2	A2			A	2.00%
	IXCBO 2006-2A C	\$ 10,000,000	watch	A2	A2			A	1.00%
	LSTRT 2006-1A D	\$ 10,000,000	watch	A2	A2			A	1.00%
	ORION 2006-2	\$ 20,000,000				Watch	A	A	2%
	\$ 259,865,240								25.99%
Pro-rata Pay?	Sequential from closing.								
Triggers			Class A	Class B	Class C				
	Principal Coverage Ratio		111.94%	106.02%	102.23%				
	Principal Coverage Test		103.70%	100.80%	100.00%				
	Difference		8.24%	5.22%	2.23%				
	*The current rating agency downgrade activity does not currently affect the OC tests. We would expect that once assets are taken off watch, that OC haircuts will kick in. We also expect potential PIK assets to affect the OC tests quickly. Further analysis is within.								
			Class A	Class B	Class C				
	Interest Coverage Ratio		168.23%	145.12%	129.34%				
	Interest Coverage Test		111.00%	108.00%	105.00%				
	Difference		57.23%	37.12%	24.34%				
	* We would not expect the interest coverage to change unless securities start to PIK which would have an affect.								
Haircuts	Haircuts in OC tests: BB assets by 10%; single B by 30%; CCC by 50%. Assets that PIK are treated are counted at the lower of market or rating agency recovery rate (approximately 65% haircut).								

Acceleration and liquidation rights	Ambac, as the Controlling Class, can direct the liquidation of the collateral upon (i) any failure to pay AA interest, (ii) any failure to pay principal, (iii) with overcollateralization haircuts, the overcollateralization percentage to the AAAs of 76.75% (which is effectively 125% to Ambac's class at origination).
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**ATTACHMENT POINT ANALYSIS****Transaction Capital Structure:****Transaction Capital Structure:**

Tranche (Moody's/S&P)	Rating	Initial Principal Amount*	Percent of Capital Structure	Coupon	WALife (years)	Expected Maturity*	Legal Final (years)
Class S	Aaa/AAA	\$39,200,000	3.8%	3 mo L +34 bps			8
Class A-1 (unfunded)	Aaa/AAA	\$500,000,000	48.0%	3 mo L +45 bps**	5.5	8 years	45
Class A-2	Aaa/AAA	\$200,000,000	19.2%	3 mo L +55 bps	7	8 years	45
Class A-3	Aaa/AAA	\$120,000,000	11.5%	3 mo L +70 bps	7	8 years	45
Class A-4	Aa2/AA	\$75,000,000	7.2%	3 mo L +120 bps	7	8 years	45
Class B	A2/A	\$50,000,000	4.8%	3 mo L +300 bps	7	8 years	45
Class C	Baa2/BBB	\$35,000,000	3.4%	3 mo L +525 bps	6.3	8 years	45
Preference Shares		\$22,000,000	2.1%	N/A	NA	8 years	45
<b>TOTAL</b>		<b>\$1,041,200,000</b>	<b>100.0%</b>				

\*8 year auction call

\*\*Unfunded cost is 28 bps and funded cost is L + 45 bps.

Ambac has sold protection on the entire unfunded Class A-1 Notes which is the most senior \$500 million in the transaction and benefits from 50% subordination including a junior Aaa/AAA tranches totalling \$320 million representing the bottom 39% of a natural AAA tranche. At Close, the 50% subordination represented 2.7x the required AAA subordination of 18.2%.

At the current time, it is not expected that an auction call will be successful unless subordinate classes would agree to reduced proceeds.

**CDO Manager Concentration (Three largest collateral managers by % of par)**

Collateral Manager	%
Harding	9.25%
ACA	7.00%
Tricadia	5.00%

**DOWNGRADE /WATCH ANALYSIS**

Cusip	Deal Name	Current Face	Moody's Action	Previous Rating	Current Rating	S&P Action	Previous Rating	Current Rating	Percent of Fund
00389PAD7	ACABS 2006-2A A3L	\$ 19,936,986	watch	A2	A2	watch	A	A	1.99%
00082WAD2	ACABS 2006-1A A3L	\$ 19,928,254			A2	watch	A	A	1.99%
15719MAC5	CETUS 2006-2A B	\$ 20,000,000	watch	A2	A2			A	2.00%
15719RAF7	CETUS 2006-3A C1	\$ 20,000,000	watch	A2	A2			A	2.00%
903399AA1	JACKS 2006-4A D	\$ 20,000,000	watch	A1	A1			A	2.00%
553129AD9	MKP 6A C	\$ 20,000,000	watch	A2	A2			A	2.00%
50547QAC1	LCERT 2006-1A B	\$ 20,000,000	watch	A2	A2			A	2.00%
87337WAD2	TABS 2006-5A A3	\$ 20,000,000	watch	A2	A2			A	2.00%
8733YAD8	TABS 2006-6A A3	\$ 20,000,000			A2			A	2.00%
25454XAD7	DGCDO 2006-2A C	\$ 20,000,000	watch	A2	A2	watch	A	A	2.00%
55313HAC2	VELA 2006-1A C	\$ 20,000,000	watch	A2	A2	watch	A	A	2.00%
45072HAJ9	IXCBO 2006-2A C	\$ 10,000,000	watch	A2	A2			A	1.00%

543175AJ2	LSTRT 2006-1A D	\$ 10,000,000	watch	A2	A2	A	1.00%
	ORION 2006-2	\$ 20,000,000				Watch A A	2.00%

\$ 259,865,240

25.99%

**Asset Analysis:**

Par Amount	1,001,472,516
Cash (including interest)	<u>345,014</u>
	1,001,817,530
% of Mezz CDO of ABS (or CDO^2)	100%
% of HG CDO of ABS	0%
% of Par Amount on Mdy's Watch	20%
% of Par Amount with an affiliate tranche on Moody's watch	38%
% of Par Amount on S&P Watch	12%
% of Par Amount on S&P or Moody's Watch	26%
% of Par Amount on S&P or an affiliate tranche on Moody's watch	44%
Subordination	50%

Affiliate tranches means any tranche in the CDO has been put on watch.

Based upon the above rating actions, the following chart highlights the watch list for CDO-squared bonds in the portfolio with additional information on the underlyings.



Mezzanine CDO of ABS to Watch (all CDO's and mezzanine CDO of ABS)

	Cusip	Highest Tranche on Mdy's Watch	S&P Watch	Portfolios	FROM UBS			Trigger	Managed	Manager	BB rated Prior to DG's	Single A Attachment	Double AA Attachment
					% DG by	% NW by	Total						
					Moody's	Moody's							
TABS 2006-5A	87337WAC4	A2	No	AA Bespoke, Class V III	28.6	6.4	35	Yes	yes	Tricadia	9.76	9.8%	15.4%
ACABS 2006-2A	00389PAC9	A2	Yes	AA Bespoke, Class V III	21.7	11.9	33.6	yes	Static	ACA	28.57	11.6%	15.5%
KEFT 2006-1	487520AJ78T	A2	Yes	888	16.4	10.2	26.6	Yes	Yes	Terwin	2.27	8.4%	12.4%
MKP CBO VI	553129AC1	Aa2	Yes	AA Bespoke, Class V III	11.5	14.9	26.4	Yes	yes	MKP	9.46	8.5%	9.9%
DGCDO 2006-2A	254XAC9	A2	Yes	AA Bespoke, Class V III	17	7.2	24.2	yes	yes	SSgA	6.53	10.4%	14.2%
Jackson 2006-4	903399AA1?	A1	No	Class V III			24.0	No	static			8%	
CETUS 2006-3A	15719RAE0	A2	Yes	AA Bespoke, Class V III	19	5	24	No	yes	GSC	0.01	12.7%	19.7%
CETUS 2006-2A	15719MAB7	Aa2	Yes	AA Bespoke, Class V III	19.8	2.5	22.3	yes	yes	GSC	0.0	9.4%	14.9% Test is A1 only
VELA 2006-1A	55313HAC28T	A2	Yes	AA Bespoke, Class V III, 888			20.2	yes	yes	MKP	0	15.5%	19.4%
OCTAN 2006-3	6757M1AF9	Baa2	Yes	Adams	14%	4%	18.0	no	yes	Harding	0	9.5%	15.0%
IVYL 2006-1	46801QAJ78T	A2	Yes	888	13.3	4.4	17.7	No	yes	Princeton	7.80	9.00%	12.7%
LCERT 2006-1	50547QAB3	A2	No	AA Bespoke, Class V III, Adams	9.4	4	13.4	yes	Static	Magnatar	0.0	9.5%	15.0% Test is A1 only
LSTRT 2006-1	543175AJ28C	A2	Yes	AA Bespoke, Class V III, 888	10.2	2.8	13	No	yes	JPMIM	3.68	8.5%	13.5%
KNOLL 2006-2	49916RAD2	A2	Yes	AA Bespoke, Class V III	7.5	2.3	9.8	yes	no	Deerfield	8.75	8.5%	13.2%
IXCBO 2006-2	45072HAJ98T	A2	Yes	888	3.4	4.3	7.7	yes	yes	IXIS	4.60	8.9%	13.1%
BFCSL 2006-1	08861KAC08T	Aa2	Yes	888	3	1	4.0	Yes	yes	Braddock	9.52	8.5%	12.5%

To be added based upon S&P actions: ACABS 2006-1A (AA Bespoke, Class V III) and TABS 2006-6A (AA Bespoke, Class V III)

**COVERAGE TEST ANALYSIS**

This deal has both principal coverage (OC) tests and interest coverage (IC) tests

There is limited reinvestment during the first three years up to 10% of the pool.

The payment sequence is sequential

	<u>Class A</u>	<u>Class B</u>	<u>Class C</u>
Principal Coverage Ratio (Actual)	111.94%	106.02%	102.23%
Principal Coverage Test	103.70%	100.80%	100.00%
Difference	<b>8.24%</b>	<b>5.22%</b>	<b>2.23%</b>
	<u>Class A</u>	<u>Class B</u>	<u>Class C</u>
Interest Coverage Ratio (Actual)	168.23%	145.12%	129.34%
Interest Coverage Test	111.00%	108.00%	105.00%
Difference	<b>57.23%</b>	<b>37.12%</b>	<b>24.34%</b>

- This pool will need to be closely monitored in the next two years as rating actions will affect the behavior of the underlyings CDOs and the triggers in this transaction.
- The pool is composed of tranches from CDOs which have OC and IC triggers and have tranches from CDOs which do not have OC and IC triggers. In addition, some of the synthetic exposures have implied writedown as a credit event (as explained below).
- The immediate and long term concern is the potential for PIK risk and implied writedowns.
  - PIK risk. For transactions that have OC and IC triggers, rating agency migration haircuts can cause junior tranches to PIK (pay in kind) as interest is diverted to other classes. Implication is that interest collections will be reduced. For OC purposes, after 2 periods of PIKing, the asset is treated as a defaulted asset for purposes of haircuts.
  - Implied writedown risk. For CDOs with triggers and those without, rating agency migration haircuts could lead to implied writedown prior to defaults (i.e., a comparison of par coverage with haircuts relative to the sum of synthetically referenced class and its senior securities. The economic effect is that this is a underlying single CDO credit event which permits the delivery of the asset. If the asset is unavailable, the CDS counterparty could claim for the writedown amount; however, as long as the full interest coupon on the underlying CDO of ABS has been paid, the CDO is entitled to interest (LIBOR + premium) on the amount of writedown paid.
- Based upon review and conversations with the portfolio manager, it is likely that one bond (MKP) will PIK in the near future. We will receive from the manager in the coming days their analysis of the OC coverages for the underlying single A CDOs.
- The expectation is that Class V will likely trip its most junior OC test in the next 6 months through a combination of PIKing bonds (1-2) and single B downgrades (1-2).